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In the United States Bankruptcy Court  
for the  
Southern District of Georgia  
Savannah Division

In the matter of:	)	
	)	Chapter 11 Case
DANIEL A. WELZEL, JR.	)	
	)	Number <u>98-42613</u>
<i>Debtor</i>	)	
	)	
	)	
ADVOCATE REALTY	)	
INVESTMENTS, L.L.C.	)	
	)	
<i>Movant</i>	)	
	)	
	)	
v.	)	
	)	
DANIEL A. WELZEL, JR.	)	
	)	
<i>Respondent</i>	)	

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**MEMORANDUM AND ORDER**  
**ON MOTION FOR RELIEF FROM STAY AND**  
**MOTION TO DISMISS**

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Debtor's case was filed on August 31, 1998. On September 25, 1998, Advocate Realty Investments, L.L.C., filed separate motions for relief from stay and motions to dismiss. Hearings on those motions were conducted on October 15, 1998. This Court has jurisdiction pursuant to 28 U.S.C. § 1334(b). This contested matter is a core proceeding under 28 U.S.C. § 157(b)(2)(A), (G). After consideration of applicable

authorities, the Court enters the following Findings of Fact and Conclusions of Law pursuant to Rule 9014 of the Federal Rules of Bankruptcy Procedure.

### FINDINGS OF FACT

At the time of filing his case, Debtor was indebted to Advocate Realty Investments, L.L.C., ("Advocate"), in the principal amount of \$986,843.06 with per diem interest accruing at a rate of \$272.61 per day. The debt was secured by first deeds to secure debt in favor of Advocate on properties in the Historic District of Savannah located on East Harris Street and West Hall Street. When this case was filed, Advocate was in the process of foreclosing its security deeds on the real estate and a non-judicial foreclosure sale was scheduled for September 3, 1998. In addition to the deeds to secure debt in favor of Advocate, the property is encumbered by state and county taxes of \$5,349.00 and liens of record in the amount of \$148,024.00, of which approximately \$72,000.00 is disputed by the Debtor.

The property on East Harris Street consists of four townhouses, numbers 530, 532, 534 and 536, which are listed for sale. Contracts are pending on two of the townhouses at a contract price of \$249,000.00 each. The properties located on West Hall Street are at numbers 221, 225, and 227. 221 West Hall is not renovated and Debtor values it at \$60,000.00. 225 and 227 West Hall Street are partially renovated and Debtor believes their value to be approximately \$320,000.00. In addition to principal and interest, Advocate claims that the Debtor is obligated to pay an additional 15% attorney's fees, statutory notice of Advocate's intent to collect those fees having been sent more than ten

days prior to the filing of the bankruptcy case. Advocate claims that entitlement to the fees is vested as a matter of state law. Debtor contends that these fees are not fixed at 15% but are subject to review for reasonableness by this Court under 11 U.S.C. § 506.

Advocate brings its motion to dismiss on grounds that the case is not filed in good faith, and moves for stay relief alleging that there is no equity and that cause exists in that Debtor has no disposable income to fund costs of completion, that at least some of the property was not insured at the date of filing, that property taxes and interest were accruing, that Debtor failed to disclose assets in his petition and had falsely claimed ownership of other assets in financial statements given to creditors pre-petition.

Debtor's most recent federal income tax return was filed for the tax year 1995 and shows adjusted gross income of \$12,813.47. (Ex. M-7). That tax return reveals no interest or dividend income. Debtor's 1996 return was not available at the time of the hearing and his 1997 return has not been filed. Debtor's schedules were admitted as Exhibit M-5. A personal financial statement dated March 2, 1998, which he executed and delivered to Suntrust Bank, was admitted as Exhibit M-11. These exhibits form the documentary foundation for the contentions concerning the truthfulness of the Debtor's schedules and his testimony. Based on an examination of those documents, I make the following findings.

- a) Debtor is obligated on a PNC Bank card, but PNC Bank was not listed as a creditor in Debtor's schedules. (Ex. M-9).

- b) Debtor listed as an asset on his financial statement property located on “Melody Lane” with a value of \$100,000.00 and encumbered by no debt. (Ex. M-11). In reality he does not own this property but expects to inherit a one-fourth interest in it with his three siblings. This asset was not listed in Debtor’s schedules. (Ex. M-5).
- c) In his financial statement Debtor listed \$10,000.00 in zero coupon bonds and series “E” bonds, (Ex. M-11), neither of which were listed in his schedules. (Ex. M-5).
- d) Debtor listed a firearms collection valued at \$20,000.00 in his financial statement (Ex. M-11), but did not schedule any firearms in his bankruptcy schedules, stating that the firearms were in the possession of a licensed firearms dealer. In Item 6(b) of his statement of financial affairs, however, he did not reveal that the firearms collection was in the hands of any custodian such as a licensed firearms dealer.
- e) In his financial statement, Debtor listed a collector’s automobile valued at \$20,000.00 which he identifies as a 1970 Mustang (Ex. M-11). This asset was not listed in his bankruptcy schedules, but Debtor testified that the automobile was actually titled in his mother’s name.

In his schedules, Debtor failed to reveal \$12,000.00 in cash surrender value of life insurance, failed to reveal \$33,000.00 equity in real estate located in Deptford, New Jersey, and failed to reveal the existence of an insurance claim for theft losses dated July 1998 and valued at \$109,000.00.

Debtor’s credibility was shown to be lacking in other material respects. First, Movant asked the Debtor if he had relinquished control over his business assets or

whether he had filed the bankruptcy case at the request or direction of another entity known as “226 West Broughton, L.L.C.” In response to this very direct question the Debtor, under oath, verbalized a very clear denial. He was then presented with Exhibit M-12, a contract entitled “Agreement of Cooperation” between Debtor and “226 West Broughton, L.L.C.” which recites that Debtor does not have the ability to fund a Chapter 11 filing or a plan of reorganization. It also revealed the Debtor had, in fact, ceded control over his business and his major assets to 226 West Broughton. The document stated:

Welzel hereby irrevocably grants to 226 W. Broughton sole control over the actions taken by Welzel in regards to the Chapter 11 case, including but not limited to sole control over the decision as to the restoration, marketing and sales for the properties as well as the payments to the creditors. Thus, during the pendency of the Bankruptcy, Welzel agrees and acknowledges that he can take no action regarding the rehabilitation, marketing and sales of the properties without the consultation, permission, and consent of 226 W. Broughton. In other words, 226 W. Broughton will have sole control over the decisions and a veto power over any action that affects the properties and/or the Bankruptcy. Specifically, and without limiting the foregoing, 226 W. Broughton will have sole decision making authority and veto power over the amount of money to be spent for the rehabilitation of the properties, the method in which money is spent to rehabilitate the properties; the amount of the sales price, the person or persons who market the sales of the properties; the acceptance or rejection from any sales offer regarding any of the properties and the distribution of any proceeds of the sale of the properties, subject to Bankruptcy Court approval.

(Ex. M-12, p. 3-4).

Second, Debtor's petition represents his address on the date of filing, August 31, to be 536 East Harris Street, Savannah, Georgia, which in fact is one of the uncompleted units which he is attempting to sell. He reiterated this contention on cross examination by stating that on August 31, he still lived at 536 East Harris Street. However, a representative of Darby Bank gave uncontradicted testimony that he routinely does inspections for construction loans for Darby Bank, that the Debtor vacated 536 East Harris Street sometime prior to August 12, and that he, the representative, had changed the locks on August 17 to 536 East Harris Street and no one besides Darby Bank had access to the premises.

Because of feasibility issues relating to this case, there was much controversy over the cost of repairing the projects in progress. Debtor estimated completion cost on the two remaining Harris Street properties, which are not under contract, at \$15,000.00 and for the two Hall Street properties, which are partially renovated, at \$20,000.00, for a total cost of completion of \$35,000.00. This testimony was called into question by Advocate's expert, who had done a detailed analysis of the necessary cost of completion and arrived at a figure of \$190,000.00 to complete the six properties, including the two under contract which had remaining work to be done prior to closing. The expert did, however, testify that he would bid a project such as this with a profit margin of 25 to 50 percent and would charge an additional 20 percent for supervision. Accordingly, even the expert's cost of completion, when discounted to the cost Debtor would incur, would be close to \$95,000.00.

Richard Mopper, a local realtor who has a listing on the subject properties and who has acted as general contractor in renovation projects in the Historic District of Savannah, testified that he had examined the properties and believed the total cost of completion of the West Hall Street properties to be \$25,000.00 and on the East Harris Street property to be \$53,000.00, for a total cost of \$78,000.00. Daniel Welzel, Sr., the Debtor's father, a self-employed contractor with years of experience and expertise in this area, testified that he was assisting his son financially in attempting to complete the projects in order to have them sold and cure the financial crisis which affects the Debtor. Mr. Welzel, Sr., also testified that he was advancing funds as necessary, that he was performing much of the work himself, and that to the extent material and supplies were necessary he would borrow from his personal bank. He believed the total completion cost on Harris Street to be approximately \$40,000.00 and on Hall Street approximately \$12,000.00. Taking all the expert testimony into account I conclude that the costs of completion of the various properties are \$75,000.00.

#### Contentions of the Parties

The agreement between the Debtor and 226 West Broughton, L.L.C., was not disclosed in the Debtor's statement of financial affairs and relinquishes total control of the conduct of the bankruptcy case in exchange for 80 percent of the net equity in the Debtor's properties. Advocate contends, first, that this agreement evidences bad faith in that the case is not being prosecuted by the real party in interest and further because the Debtor failed to reveal the existence of that contract in his schedules and statement of financial affairs. Advocate contends, second, that the Debtor failed to file materially

truthful schedules by not revealing certain assets that were claimed in his personal financial statement, that the Debtor has no viable business or income with which to fund the completion of the properties in question, that both he and his only employee are collecting disability and that he has failed to insure or has underinsured the properties.

Debtor contends that the execution of the agreement with 226 West Broughton was not intended to harm anybody but rather to protect creditors and retain for the Debtor a 20 percent interest in the profits of the enterprise. Debtor also argues that the \$100,000.00 house which was not scheduled is in fact held for him in trust and that he expects to inherit a partial interest in it at some point. Debtor further contends that the pendency of the two contracts for the sale of units on Harris Street will infuse the estate with over \$400,000.00 in proceeds which can be used to reduce the debt to Advocate, reduce the interest accrual and give the Debtor a better opportunity to complete repairs with the assistance of his father and successfully liquidate while protecting all creditors.

### CONCLUSIONS OF LAW

This case presents the Court with a difficult determination. It perhaps can best be stated this way. What is the proper result when the Court is faced with a motion to dismiss or for relief from stay by a creditor holding security interests in the vast majority of the Debtor's collateral under the following circumstances?

- (1) Movant has failed to prove lack of equity. Even if the full 15 percent attorney's fees has accrued, the total debt, including per diem interest, taxes and undisputed liens, is



approximately \$1,224,500.00 and the total value of the real estate is approximately \$1,380,000.00 less costs to complete of \$75,000.00 or \$1,305,000.00.

- (2) Debtor has insufficient income or other resources with which to successfully complete the unfinished properties, which are presently on the market, yet has what appears to be an earnest but ill-defined commitment from his father to assist in the completion of the properties.
- (3) The material omissions from Debtor's schedules, or alternatively the misrepresentations on his financial statement given to Suntrust Bank, are so substantial as to fundamentally call into question both his fitness to act as a debtor-in-possession and his personal credibility.

Having concluded that Advocate has failed to prove lack of equity, stay relief can only be granted for "cause." Alternatively, the case can be dismissed for cause if the case was filed in bad faith. Controlling precedent in this circuit is exemplified by the cases of In re Phoenix Picadilly, 849 F.2d 1393, 1394 (11th Cir. 1988) (case dismissed for bad faith despite prospects of successful reorganization), and In re Albany Partners, 749 F.2d 670, 675 (11th Cir. 1984) (Section 1112(b) determination of "cause" subject to judicial discretion, including finding of bad faith).

These cases do not expressly deal with the issue of a debtor who has prepared false and misleading schedules in its filings with the Bankruptcy Court, or has produced and delivered false and misleading statements to a bank from whom he was attempting to obtain credit. Even so, the execution of schedules under penalty of perjury

which are materially false, or the execution of a false personal financial statement certified to a bank to be true and correct, constitutes a federal crime. *See* 18 U.S.C. § 152<sup>1</sup> and 18 U.S.C. § 1014.<sup>2</sup> Either act also amounts to such misconduct as to justify a finding that the case has not been filed in good faith. *See In re Coffee Cupboard, Inc.*, 119 B.R. 14, 18 (E.D.N.Y. 1990) (debtor's concealment of assets and false filings with bankruptcy court

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<sup>1</sup> 18 U.S.C. § 152 provides:

A person who--

(1) knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from the creditors or the United States Trustee, any property belonging to the estate of a debtor;

(2) knowingly and fraudulently makes a false oath or account in or in relation to any case under title 11;

(3) knowingly and fraudulently makes a false declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, in or in relation to any case under title 11;

(4) knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under title 11, in a personal capacity or as or through an agent, proxy, or attorney;

(5) knowingly and fraudulently receives any material amount of property from a debtor after the filing of a case under title 11, with intent to defeat the provisions of title 11;

(6) knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11;

(7) in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers, or conceals any of his property or the property of such other person or corporation;

(8) after the filing of a case under title 11 or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any recorded information (including books, documents, records and papers) relating to the property or financial affairs of the debtor; or

(9) after the filing of a case under title 11, knowingly and fraudulently withholds from a custodian, trustee, marshal, or other officer of the court or a United States Trustee entitled to its possession, any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor,

shall be fined under this title, imprisoned not more than 5 years, or both.

<sup>2</sup> 18 U.S.C. § 1014 provides:

Whoever knowingly makes any false statement or report . . . for the purpose of influencing in any way the action of . . . any institution the accounts of which are insured by the Federal Deposit Insurance Corporation . . . upon any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, or loan, or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release, or substitution of security therefor, shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.

are admissible as evidence of bad faith).

To grant stay relief or to dismiss the case and leave the parties to their state law remedies will, in all likelihood, adversely affect the interest of junior lienholders on the Debtor's property and unsecured creditors. In a properly managed liquidation or reorganization, these parties could expect to receive some benefit. Therefore, while stay relief or dismissal because of the Debtor's misconduct would, in the abstract be justified, it could be seriously detrimental to the interest of creditors. On the other hand, to excuse the Debtor's misconduct because dismissal would harm those interests would, in every case, eviscerate the penalties for such misconduct.

I have concluded that the proper result is to convert this Chapter 11 case to a case under Chapter 7 so that a trustee can be appointed to conduct an orderly liquidation of the assets and attempt to achieve the greatest benefit to the junior lienholders and unsecured creditors in this case. Advocate did not seek conversion or dismissal in either of its motions before the Court and no party in interest has filed a motion to convert this case. However, 11 U.S.C. § 1112(b) provides the remedy of conversion for "cause." Enumerated "causes" under Section 1112 are clearly non-exclusive. I have concluded that cause to convert or dismiss a case exists if the debtor-in-possession has been shown to be incapable of performing the duties incumbent upon a debtor-in-possession. *See In re Fiesta Homes*, 125 B.R. 321 (Bankr. S.D.Ga. 1990) (plan which required debtor-in-possession to recover preferences from family members or members of management could not be confirmed because debtor-in-possession could not demonstrate with certainty that it would

properly fulfill duties in implementing plan).

In converting this case on my own motion, I acknowledge the distinction between a court's ability to take such action on its own under pre and post-1986 amendments to the Code. Prior to 1986, bankruptcy courts in this Circuit did not have authority to convert a Chapter 11 on their own motion. In re Moog, 774 F.2d 1073, 1076 (11th Cir. 1985); *see also* In re Hale, 65 B.R. 893, 897 (Bankr. S.D.Ga. 1986) (Davis, J.) (denying confirmation but declining to dismiss absent motion from party in interest). In 1986, however, Section 105(a) was amended to add the following language:

No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

Pub. L. No. 98-531, § 203 (1986). The Eleventh Circuit has not addressed the effect of this amendment on its decision in Moog. The rationale of the Moog opinion, however, is superseded by the later grant of discretion to bankruptcy courts by the amendment. Accordingly a *sua sponte* order converting this case is permissible under Section 105.

The authority granted by amended Section 105(a) is not absolute, however. This Court may only act *sua sponte* as “necessary and appropriate . . . to prevent an abuse of process.” I hold, therefore, that such action is in fact necessary and appropriate in this

case. Debtor's credibility is non-existent. In the absence of a credible individual to shoulder the fiduciary responsibilities of a debtor-in-possession, and to respond in an appropriate way to Debtor's misconduct, I hold that it is appropriate to order *sua sponte* that the case be converted to Chapter 7.

It is axiomatic that one of the fundamental principles of bankruptcy is that it is intended to provide to the honest but unfortunate debtor a fresh start. It is also clear that permeating the entire Code and Rules governing bankruptcy practice and procedure is the requirement of full complete disclosure. Debtor fails the honest but unfortunate test and fails the full and complete disclosure test in the eyes of this Court. On the other hand, the Debtor, having sought a remedy under Title 11, should not be heard to complain if the Court determines that it is in the best interest of creditors to afford him a remedy under Chapter 7, rather than Chapter 11 and in preference to dismissal, which would leave him subject to the multiple claims and proceeds brought by his numerous creditors. Debtor will still personally benefit by an orderly liquidation and by the existence of an automatic stay against creditor actions which this Court can regulate and modify. Moreover, the paramount interest of all creditors will be protected by the appointment of a trustee and orderly liquidation of Debtor's assets located both in this jurisdiction and out of state.

### O R D E R

In light of the foregoing findings and conclusions IT IS THE ORDER OF THIS COURT that Debtor's Chapter 11 case be converted to a case under Chapter 7, that a Chapter 7 trustee be appointed immediately, and that a creditors' meeting be convened.

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Lamar W. Davis, Jr.  
United States Bankruptcy Judge

Dated at Savannah, Georgia

This 21st day of December, 1998.